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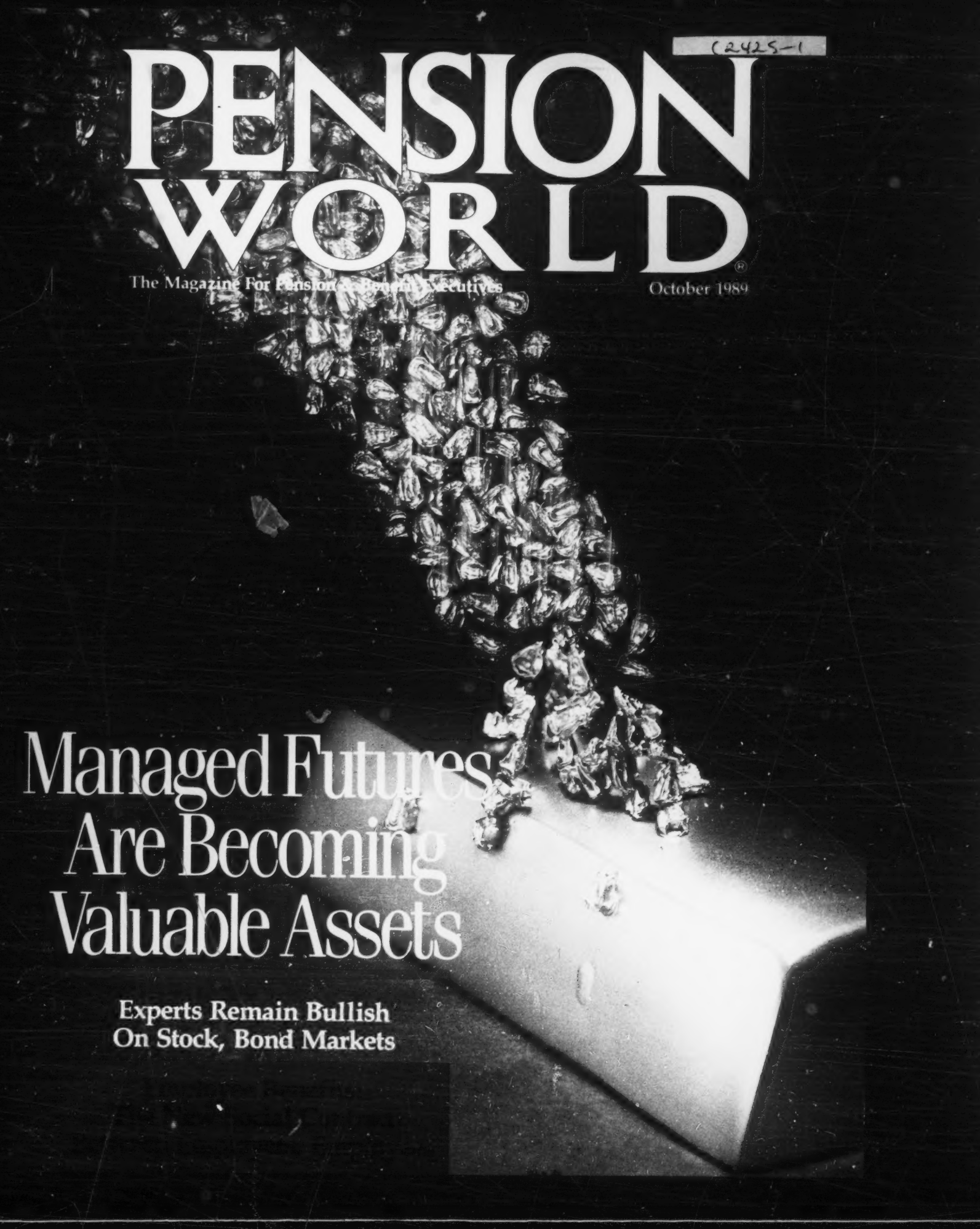

Managed Futures Are Becoming Valuable Assets

Experts Remain Bullish On Stock, Bond Markets

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About The Cover: Futures managers can allocate assets strategically among a broad variety of markets, such as foreign exchange, precious metals, energy, finance and agriculture. Our cover story on managed futures begins on page 12.
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Open-end fund index return decreases

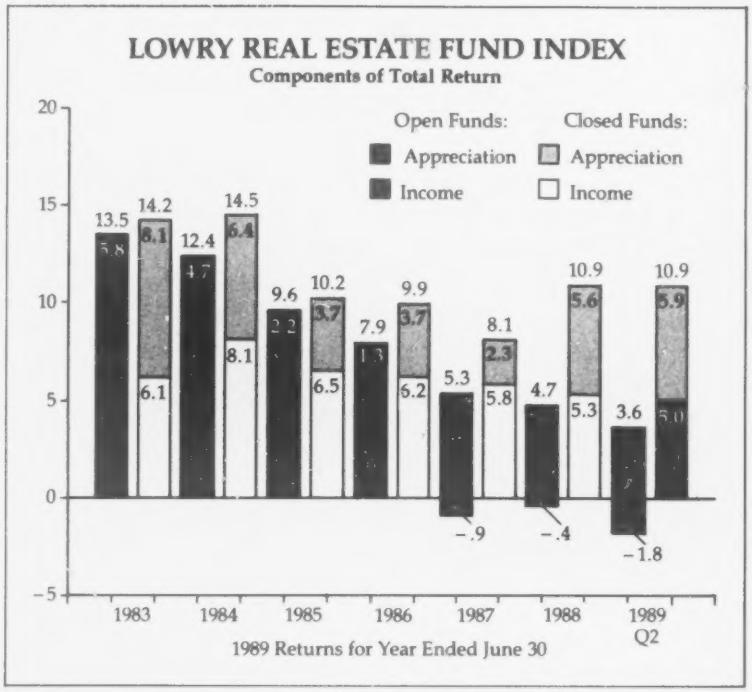
The Lowry Real Estate Fund Return Index income and appreciation components are reported for 1983-88 and the year ended June 30, 1989. The open-end fund index annual return was 3.6 percent for the year ended June 30, 1988, according to Michael Oliphant of Pension Real Estate Services Inc. in Atlanta. The closed-end fund index return for the four quarters ended June 30, 1988, was 10.9 percent compared to 9.5 percent for the previous year. The combined index return for the most recent annual period was 6.4 percent compared to the previous year's 6.6 percent. Three open-end fund managers reported substantial reductions in value for the quarter.

Total investment returns include income and appreciation. Income is stated as a percent of the current market value. Appreciation reflects changes in the market value as measured by appraisals. All returns reported are net of management fees.

Income returns reported for the quarter by the open-end fund managers range from 1.2 percent to 1.9 percent with an average of 1.4 percent. Appreciation returns provided by the open-end funds for second quarter 1989 ranged from −6.1 percent to 1.8 percent. The closed-end fund income returns ranged from a low of 0.6 percent to a high of 1.9 percent with an average of 1.2 percent. The closed-end funds reported appreciation ranging from −2.3 percent to 5.1 percent.

The income component of return should be relatively stable across time, regions and property type. Deviations from "market" income returns may provide an indication of pending changes in appraised value. For example, a fund with above average income returns will probably soon report appreciation that will tend to bring the income returns (stated as a percent of the new market value) downward to be consistent with the market.

There are other explanations for differences in income return provided by commingled real estate funds that should be understood. These include differences in the level of leverage employed, acquisition of properties that are not fully leased, the deal structure used, accounting practices, the amount of fees collected and capitalization rates that differ depending on property type and location.



Since more than one-third of the total return reported by the index funds from 1983 to the present has been due to changes in value of property, it is critical for investors to have an understanding of the appraisal process. Appraisals are performed by independent appraisers, but the fund manager bears ultimate responsibility for the results of the appraisal.

Also, appraisers are charged with expressing an opinion of the most probable selling price of a given property under competitive conditions.

Developing a value estimate using the income approach requires the appraiser to have current knowledge about market capitalization rates. For example, if the current annual income provided by a property is divided by the capitalization rate to determine value, a property with annual net operating income of $1 million would be valued at $12.5 million if the current cap rate is 8 percent. A small change in the cap rate will result in a large change in value.

In practice there are many more assumptions that must go into an appraisal. Future cash flows are estimated through analysis of current leases and future vacancy rate predictions, changes in expected rent and operating expenses, and predicting a future selling price using a terminal cap rate applied to the final year expected income.

Investors should go beyond accepting the numbers provided by managers and examine very closely the assumptions that are behind the appraisals. For example, in markets where there are huge amounts of empty office space and rents have been declining, lease-up and rental increase assumptions should match market conditions. This quarter's write downs in value have come primarily from open-end fund managers with redemption requests who are faced with selling properties to raise cash. A thorough analysis of appraisal assumptions provides the key to determining whether other funds would have similar write downs if faced with the reality of the market.

For further information on the Lowry Real Estate Fund Indexes, contact Michael Oliphant, Pension Real Estate Services, Lowry Consulting Group, Atlanta, Ga., (404) 431-1120.